Pakistan Strategy

October 2008

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KSE-100 Index
9,184.24

KSE Market Cap
PkR2,840bn (US$34,055mn)

KSE-100 Mkt Cap as % of Total Mkt Cap.
88%

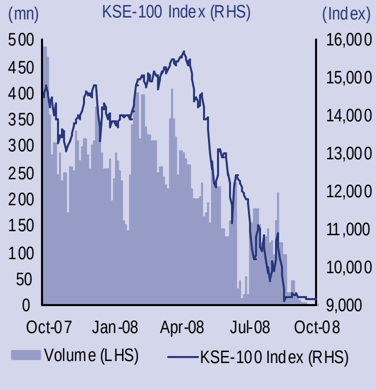
1 Year KSE-100 High/Low
15,676.34/9,144.93

12m KSE-100 Avg. Traded Value
PkR19,822mn (US$237.67mn)

KSE-30 Mkt Cap. as % of Total Mkt Cap.
17%

YTD KSE-30 High/Low
18,987.89/10,013.71

AKD Universe
72% of KSE-100 Market Cap.



A crisis of confidence!

Uncle Sam's financial worries have snowballed into a global financial crisis, reducing growth prospects and undermining risk tolerance (see annexure for pictorial on subprime crisis). Increased risks to global GDP growth have resulted in a sharp revaluation of asset classes. The infection is widespread - confidence dispersion in the financial system has created a series of bank runs and governments have rushed to announce wide-scale bailout programs to avert a systemic collapse. Fear has gripped all stakeholders, even seasoned investors; with the fallout of the financial crisis likely to have consequences for the public at large if broader corrective measures are not implemented in a timely manner. The entangled global economy faces a slowdown where Asia's broader decoupling argument is likely to prove unrealistic. Within that backdrop, domestic demand stories like Pakistan have the potential to buck the trend and bottom out ahead of the curve. The crux for a resurgent Pakistan depends upon suitable policy response; from a regulatory perspective, systemic risks have to outweigh short-term inflationary concerns. Passive policy response, however, poses downside risk.

Major World Indices YTD Performance

Date	31-Dec-07	*27-Aug-08	17-Oct-08	Year to floor	Aug 27 to Date
Pakistan	**14,075.83**	**9,144.93**	**9,184.24**	**-35%**	**0.4%**
Sri Lanka (CSE)	2,563.4	2,406.4	1,998.8	**-6%**	-16.9%
Thailand (SET)	858.1	676.0	471.3	**-21%**	-30.3%
Indonesia (JKSE)	2,674.0	2,131.1	1,399.4	**-20%**	-34.3%
Malaysia (KLSE)	1,445.0	1,067.7	905.2	**-26%**	-15.2%
Philippines (PSEi)	3,617.3	2,646.7	2,098.3	**-27%**	-20.7%
Vietnam	927.0	561.9	382.5	**-39%**	-31.9%
Brazil (Bovespa)	63,886.1	55,519.2	36,399.1	**-13%**	-34.4%
Russia (RTSI)	2,283.1	1,589.1	667.6	**-30%**	-58.0%
India (SENSEX)	20,206.9	14,296.8	9,975.4	**-29%**	-30.2%
China (SSEC)	5,261.6	2,342.1	1,930.7	**-55%**	-17.6%
S&P 500 Index	1,468.4	1,281.7	940.6	**-13%**	-26.6%
NASDAQ Composite	2,652.3	2,382.5	1,711.3	**-10%**	-28.2%
FTSE 100 (U.K)	6,456.9	5,528.1	4,063.0	**-14%**	-26.5%
Germany (DAX:IND)	8,067.3	6,321.0	4,781.3	**-22%**	-24.4%
NIKKEI 225 JAPAN	15,307.8	12,753.0	8,693.8	**-17%**	-31.8%

*Price floor imposed on KSE — Source: Yahoo Finance & Datastream

Pakistan Market - A case for bottoming out! The KSE-100 Index has lost 40% from its April'08 peak and has been at a standstill with a price deck since Aug 28th, 2008. This has provided temporary refuge from negative developments (surging terrorism, ratings downgrade, capital flight, liquidity mismanagement, etc) over the past seven weeks. Within the backdrop of negative developments that have dominated headlines, the underlying improvement in economic fundamentals has been given short shrift. As confidence fades due to systemic risk, policy response has yet to prioritize growth. We have consistently highlighted the adverse impact of excessive monetary tightening. In our previous report (titled Pakistan Economics: "Interest rates hike - a misadvised policy and a counter productive strategy?" dated: 27-7-08), we stressed that policy mismanagement by the central bank could risk taking the system to the verge of collapse. We hate to say we told you so, but the central banks policy makers now find

McCain: *"We need to help the Pakistani government go into Waziristan…and get the support of the people, and get them to work with us and turn against the cruel Taliban and others." (Oct 7)*

Obama: *"We're going to encourage democracy in Pakistan, expand our non-military aid to Pakistan so that they have more of a stake in working with us, but insisting that they go after these militants." (Oct 7)*

Privatization proceeds - FY08

Unit Name	Sale Price (PkRmn)	Date of Transfer
UBL GDR (26,392,660 shares)	5,159	7-Jul
HBL IPO (51,750,000 shares)	12,161	7-Oct

Source: Privatization Commission

Sovereign ratings and market valuations reflected weak economic indicators and an economy that was susceptible to economic volatility in the late 90s. The difference this time is that while sovereign ratings and market valuations are similar, today's macro indicators are markedly better.

themselves in a trouble shooting situation. At the same time, matters have been compounded by media-savvy economists distorting Pakistan's underlying reality, thereby risking impairment of the real economy. **We thus laud recent steps taken by the central bank's to ease the CRR and reclassify the SLR but continue to stress that in order to embed the recovery process the policy rate needs to be cut by at least 2%-3%.** Recent measures have been targeted to address the crisis facing the banking sector. A cut in the policy rate would stimulate the financial markets, jump start the broader economy and reverse recent dollarization. However, the IMF as a last resort represents a potential barrier to monetary easing. In this regard, policy makers need to emphasize that significant fiscal discipline is already in place AND inflation has already peaked.

Pakistan's economy has been passing through a turbulent phase since December '07, which coupled with high demand pressures and inappropriate policy responses have led the economy to a sub-optimal equilibrium. The selloff witnessed post April'08 broadly tracked the deterioration in the country's economic fundamentals. While general perception looks towards a discounting of the aforementioned negatives post dislodging of the price deck, we believe the market will be quick to reflect a completion of Pakistan's economic "El-Nino" cycle. **In other words, a likely easing of twin deficits ahead, fiscal austerity and softening inflationary pressures are welcome developments that point towards the road to macro economic consolidation.**

The focal point however, remains foreign inflows. Pakistan's debt raising capacity and privatization flows are to remain subdued where policy response to the global financial crisis would take time to work through risk aversion. Focus now turns to multilateral and bilateral proceeds. In the context of such proceeds, the shape of US Foreign Policy and Pakistan's continued inclusion as a frontline state in the War on Terror is likely to play a pivotal role. The GoP has till now been unsuccessful in significantly leveraging its democratic credentials and its frontline role in the broader War against Terror, in obtaining external financing. However, we believe that this would prove to be an important factor in the Friends of Pakistan conference to be held next month. Statements by US Presidential hopefuls call for a holistic approach to the struggle in Pakistan's northern areas which is underlined by taking the native population on board and creating a wider acceptance of the War. This dovetails the creation of equal economic opportunity where we feel that focused project and infrastructure financing provides the platform and widens the door to lateral inflow (see quotes).

Economic Indicators

	June'98	June'02	Sep'08
1. Real GDP growth %	3.5	3.1	5.8
2. Nominal GDP US$ bn	76.0	72.7	160.0
3. Per Capita Income $	483.0	498.0	1,050.0
4. Population mn	131.5	146.0	160.0
5. Forex Reserves bn US$	1.7	6.4	8.6
6. PkR/US$	44.7	60.1	81.0
7. M2 growth %	14.5	15.4	(2.0)
8. CPI inflation	7.8	3.5	23.9
9. Discount rate	18.5	9.0	13.0
10. 10Y PIB	15.0	10.9	14.5
11. 12M T Bill	16.0	7.0	11.8
12. Foreign debt as a % of GDP	28.6	40.8	28.1
13. Total Domestic Debt as a % of GDP	42.3	39.3	30.0
14. Total Public Debt as a % of GDP	70.9	79.8	58.1
15. Total debt servicing as a % of GDP	10.4	10.0	4.0

Source: Datastream

In a scenario where interest environment softens, domestic demand at a vital per capita income of US$1000 will again be leveraged to harness economic growth.

Coming back to our domestic demand theme, Pakistan like all other populous countries, is a domestic demand driven economy. The demand curtailment measures taken by the GoP on both fiscal and monetary fronts to tame spiraling inflation are now ingrained in economic activity. However, we are of the view that the peaking of inflation in Sep 08 signifies a reversal in inflationary trend. **This might lead to an earlier than expected easing of the SBP's tight monetary stance.** In a scenario where interest environment softens, domestic demand at a vital per capita income of US$1000 will again be leveraged to harness economic growth.

The Stock Market: We share consensus views regarding a potential 15%-20% downside to the market which should be largely premeditated and is partially aligned with the sovereign ratings set. However, comparing today's market with the situation in the late 1990's, would be misleading. Anticipating a similar downside is unrealistic in our view given the stark differential in macro economic fundamentals between now and then (see table on previous page). Our achievements of the last decade are visible and a resilient economy capable of handling economic shocks is in place. The difference in economic indicators vindicates that fact. To marginalize Pakistan domestic demand story and an economy that survived the perfect storm (global commodity shocks and a prolonged government transition) would mean we are far from throwing in the towel. That said, systemic risk could create further lows in the current cycle. In the immediate term, three outstanding issues (among others) need quick resolution and policy action: 1) the prevailing lack of confidence in the financial system, 2) concerns over the potential foreign selloff post unfreezing the market and 3) market liquidity.

Global Market Stabilization Measures

Country	Key Interest Rate	CRR	Money Market Measure	Market Measure
US	↓50bps to 1.50%	NA	US$250bn rescue plan to buy bank shares"	Temporarily bans short-selling in 799 financials
EU	↓50bps to 3.75%	NA	EUR1.03tn in guarantees	Selectively bans short-selling for a limited period
UK	↓50bps to 4.50%	NA	GBP500bn bail out plan Short selling prohibited in 32 financials Raises the limit of the amount of deposits that are guaranteed	
Canada	↓50bps to 2.50%	NA	NA	Temporarily bans short-selling
Switzerland	↓50bps to 2.25%	NA	NA	Temporarily short-selling in shares of 7 financials
Sweden	↓50bps to 4.25%	NA	NA	NA
Australia	↓100bps to 6.0%		Guarantee all bank deposits for three years Temporarily bans short selling for 30 days Backing for wholesale funding and deposits will be restricted to securities with terms of five years or less RBA injected an additional net A$1.8bn into the financial system	
China	↓27bps to 6.93%	NA	CRR rates were reduced by 100bps for all banks, except the top five banks. Further cut by 50bps on Oct 15, '08. Suspended approvals for initial public offerings from banks	NA
Hong Kong	↓150bps to 2.0%	NA	Temporary liquidity assistance for local banks	NA
Taiwan	↓37.5bps to 3.25%	NA	NA	National Financial Stabilization Fund to support for stock market when post a temporary ban on short-selling in 150 stocks. Trading was suspended on the Stock market following a sharp reduction in market capitalization in Asian bourses
South Korea	↓25bps to 5.0%	NA	Govt. to provide liquidity to smaller companies that are suffering losses from trading knock-in knock-out options (KIKO). Continue providing foreign currency until the market stabilises	Complete ban on short-selling of all stocks and allowed listed companies to buy back.
UAE	↓50bps to 1.5%		Govt. guaranteed bank deposits and interbank lending	NA
India	↓100bps to 8%	↓150bps to 7.5%	NA	NA
KSA	↓50bps to 5.0%	↓300bps to 10.0%	Government to guarantee bank deposits	NA
Russia	↓50bps to 5.0%	Set CRR to 0.5%	Central bank will raise deposit rates by 50bps as of Oct. 15, '08. The central bank announced changes on a range of non-benchmark interest rates	Closed markets for a day Trading suspended seconds after opening Ban on naked short sales Revised trading parameters Extension in trading hours

Source: AKD Research & Datastream

In our view, the Pakistani banking system can be termed as "World-Class" from a regulatory perspective

Interestingly, despite the liquidity infusion the PkR gained 3.2% from its low against the US$. This vindicates the need for further confidence building measures

Bank Runs - A hit on confidence: This is the perfect example of the prevailing confidence crisis. Compared to banks globally, the local banking sector is on a much sounder footing and is shielded from the global subprime blow out. Relative capital adequacy remains higher versus regional peer group (Pakistan CAR ratio requirement is 10%, where most banks continue to maintain a comfortable cushion over mandatory requirements). The Pakistani banking system still being in a nascent stage of development continues to rely mostly on plain vanilla products, unlike the rest of the world which is exposed to sizeable financial synthetics and derivatives which created systematic risk. Interestingly, despite a marked difference in the risk exposure of the domestic banking sector relative to global banks, we have observed a similar public response leading to a liquidity crunch. Reports of queues outside specific bank branches late into the night would have been comical if not for the gravity of the situation. Tight liquidity brought an appropriate policy response from the SBP which moved to relax the CRR requirement, by 400bps in phases till mid Nov (to release a projected PkR120bn). Allowing discount window borrowing against HTM securities and reclassifying parameters of the SLR is also expected to release PkR120bn taking total liquidity infusion to PkR240bn. At the same time, while the SBP has reiterated that its overall monetary stance remains unchanged; reading between the lines, we believe that possible monetary easing might be in the offing in the near-term in our concerted opinion. The sooner the better.

Mounting foreign pressure on equity: Market concerns have spiraled over the estimated US$1.8bn-US$2bn in foreign holding that could be on its way to the trading screen once the price deck is dislodged. Based on market quotations, off-market transactions have been taking place at about 10%-15% discount to the deck price. Street rumors suggest that roughly 20%-40% of the total FII holding could find itself on the selling screen which implies US$320mn-US$650mn in outflows. However, foreign buying at around those levels cannot be ruled out considering attractive valuations and foreign currency rates. While a range of numbers is available in market hearsay, based on Bloomberg data, MTD outflows as a % of total YTD outflow in regional markets range between 5%-14% in Oct'08, with YTD outflow from regional markets itself averaging 2.35% of market capitalization. Applying that average to Pakistan's case shows potential incremental FII selling of US$433.77mn - falling within street estimates.

Selected FII Holding

FII holding exclusive of non-reported	Foreign Holdings (shrs mn)	Fgn Hold. as % of Free Float	Current Price (PkR)	Foreign Holdings (US$ mn)
NBP	21.0	11.7%	93.02	24.6
UBL	7.5	2.5%	68.25	6.5
OGDC	254.3	40.5%	94.43	303.0
MCB	75.5	21.8%	235.75	224.5
PPL	16.5	9.6%	193.65	40.3

Source: Bloomberg

Foreign Portfolio Outflows

	WTD Net (mn US$)	MTD Net (mn US$)	YTD Net (mn US$)	Mkt Cap (mn US$)	Net Flow as % of Mkt Cap	MTD as % of Mkt Cap	MTD as % of YTD
India	(1,199.9)	(1,529.7)	(10,755.1)	710,054	-1.51%	-0.22%	14.22%
Indonesia	(28.7)	(10.6)	808.0	116,648	0.69%	-0.01%	-1.31%
Philippines	(6.7)	(87.9)	(744.8)	104,101	-0.72%	-0.08%	11.80%
S. Korea	(434.5)	(1,583.5)	(33,814.7)	569,532	-5.94%	-0.28%	4.68%
Taiwan	(44.3)	(1,647.8)	(13,159.3)	432,532	-3.04%	-0.38%	12.52%
Thailand	(13.7)	278.0	(4,155.8)	116,648	-3.56%		
Vietnam	(4.0)	(25.4)	440.3	9,703		-0.26%	-5.77%
Average					**-2.35%**	**-0.20%**	**6.02%**
Pakistan	0.2	5.1	(407.2)	35,849	-1.14%	0.01%	-1.24%

Source: Bloomberg

Based on reports, PkR20bn has been mobilized and is to be managed by NIT.

However, our estimate remains ballpark given lack of information regarding FII holding as a % of market cap in the region. **We believe mobilizing state institutions with PkR40-PkR50bn in liquidity is a necessary measure to alleviate domestic investor apprehensions regarding the awaited sell-off. Based on reports, PkR20bn has been mobilized and is to be managed by NIT.** The step though positive, requires additional funds as aforementioned above to provide us comfort. The proposal to provide FIIs with a put option for comfort against loss in currency value is also a positive sign. In this regard, the proposed Fund and local buying may take care of foreign selling but there may be a squeeze on scarce foreign currency and put a dampener on the government's efforts to mobilize forex reserves. Nevertheless, we believe foreign investors would fare better in waiting out the current downturn, where Pakistan looks to rebound quicker than regional peers that are more intertwined with the global economy.

CFS rates have averaged about 30% over the last week and spiking to over 50% the week before, as price distortion remains a key area of concern. Shortcomings in the CFS system have manifested themselves particularly where financiers in the CFS Mk-II market have shown their inability to provide their committed funding.

Surging CFS Rates and drawdown - Creating systemic risk! High counter party risk and pricing distortion (because off market transactions are being reported at 10%-15% discount to the deck price) has placed the CFS financing system under stress. CFS rates have averaged about 30% over the last week and spiking to over 50% the week before, as price distortion remains a key area of concern. Shortcomings in the CFS system have manifested themselves particularly where financiers in the CFS Mk-II market have shown their inability to provide their committed funding. Resorting to fresh funds under broker margin financing by domestic banks was also reportedly rebuffed on similar concerns over the underlying value of the security. As a result, despite the Index at a standstill, the risk of a systemic chain of defaults surfaced. Rollover issues emerged at the CFS counter because of the funding gap created as a result of the price distortion. Latest news flow indicates that banks have been forced by the SBP to provide liquidity to the system is a hidden positive. However, regulators need to ensure implementation for a smooth transition.

A greater display of "ownership" by the GoP will go a long way towards restoring confidence

Confidence Building Measures: We maintain our stance that monetary conditions should be loosened. This is necessary as monetary assets have witnessed a decline and incremental inflation is likely to accelerate its negative trend over the next 2-3 months due to the follow-up effect of the sharp fall in international commodity prices. Apart from immediate measures to lower financing costs and increase liquidity into the system, we recommend the following additional confidence building measures which are largely underpinned by a need to create a sense of ownership by the government to shore up economic confidence:

- **Expediting the Buy Back Process:** In order to cater to the current issue of low confidence, the process of share buy back should be expedited through lowering red tape. NBP and OGDC have already announced intended share buy backs while other companies should be encouraged to follow suit. Despite news flow, response to corporate buy backs has largely been muted. A transaction completion time of 2 months (stated in media reports) is not quick enough. Fast tracking the process should abate the potential selling pressure from potential foreign offloading, in our view. We stress the need for taking timely actions given the gravity of the situation, but unfortunately the management of both these government controlled entities are treating the buy-back as a routine process which is delaying implementation.
- **Cross Holdings:** Global governments have stepped up to bail out distressed lenders by taking up ownership stakes (the US government has unveiled a US$250bn package). We believe that similar steps should be encouraged particularly between government entities. Assuming selling pressure snowballs under tight liquidity conditions, we believe government intervention to encourage cross horizontal or diversified holdings would serve to relieve pressure. We recommend that the GoP

should proactively use its majority shareholding in unleveraged entities to take equity exposure in other entities in the same sector or in other sectors where valuations are attractive. In our base case, we recommend OGDCL, with liquid assets of over PkR17bn to invest in the shares of other companies like PPL. This should be achieved through a resolution by the BoD and without involving prolonged legal hassles, which unnecessarily delay the need for timely implementation.

- **Attract funds by Non-Resident Pakistanis:** In order to raise vital foreign exchange, a combination of shareholding and debt instruments in public companies may be offered to non-resident Pakistani's which can be achieved on a fast-track basis. We have seen enthusiasm in non-resident Pakitani's during the last tenure of PML-N, when similar initiatives ("Qarz Utaro Mulk Suwaro") were taken.

Pakistan's valuation discount to the region has narrowed and we see no reason why it should not continue narrowing. Improvement in risk tolerance and a limited downside to the earnings cycle relative to regional peers creates a case for outperformance

So what should the investor do? The valuation discount to regional peers has narrowed following the turmoil in global equity markets. That said, Pakistan has remained relatively immune to global events where regional economies may not be so lucky. This leads us to revisit Pakistan's valuation discount argument. At the same time, market consensus looks to have consolidated at a 15%-20% downside once the price deck is dislodged, which in our view would largely be premeditated. We believe the market has the ability to bounce back depending upon the strength of policy action to stabilize the economy, external account position, financial system and confidence. While we see risks to corporate earnings as the economy consolidates, we believe investors would do well to maintain a positive but selective view. The high cost of doing business, demand destruction manifesting itself across a broad spectrum of sectors and policy inconsistency or policy inaction form the biggest downside risk to sapping corporate profitability. On the flipside, the valuation argument, expected overall volume uptick in FY10 and increasing risk tolerance (returning confidence) sets up an investment case.

Country Valuations

	PER		EPS Growth		PBV		ROE		DY	
Country	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
China	8.5	7.4	13.2%	14.8%	1.50	1.3	20.0%	17.3%	4.3%	10.0%
Hong Kong	10.3	9.7	-14.9%	6.3%	1.00	0.9	9.4%	9.5%	5.1%	5.4%
India	11.0	8.9	10.5%	23.2%	2.00	1.6	17.9%	18.1%	0.0%	2.3%
Indonesia	8.2	6.4	11.7%	29.4%	2.20	1.8	26.6%	28.4%	10.0%	5.8%
Korea	9.3	8.0	-0.6%	15.6%	1.20	1.0	12.6%	13.1%	2.6%	2.7%
Malaysia	10.7	10.3	3.9%	3.3%	1.50	1.4	14.3%	13.9%	5.6%	5.4%
Pakistan	**8.0**	**6.7**	**7.7%**	**19.1%**	**1.70**	**1.5**	**21.4%**	**22.7%**	**7.3%**	**9.2%**
Philippines	11.3	10.0	-2.6%	13.4%	2.00	1.5	14.4%	15.2%	5.3%	5.3%
Singapore	9.4	8.9	-6.9%	5.7%	1.60	1.1	12.8%	12.7%	5.8%	6.1%
Taiwan	11.1	10.2	-23.1%	9.8%	1.20	1.2	10.0%	11.7%	6.6%	6.7%
Thailand	6.3	5.9	10.2%	6.6%	1.20	1.0	17.3%	16.6%	6.6%	7.1%

Source: AKD Research, MSCI & Datastream

Imported cost side pressures are easing and we believe 2HFY09 margin expansion is on the cards providing the basis for a positive view at current valuations particularly as monetary easing likely works its way through to FY10.

Within AKD Research's coverage cluster, consumer-oriented sectors such as Autos, FMCGs and Cement face further moderate risk to topline. However, imported cost side pressures are easing and we believe 2HFY09 margin expansion is on the cards providing the basis for a positive view at current valuations particularly as monetary easing likely works its way through to FY10. At this time though, we prefer sectors on which the current economic environment has a relatively benign impact. Oil and Gas exploration companies remain our favorite with exploration news flow and ramp ups in production which should be complemented with expanding returns backed by weakness in the PkR even in a case where international oil prices ease further. This year's pro-agri outlook keeps Fertilizers on our top picks list and the recent ECC confirmation of the subsidy on DAP should bode well for overall earnings. At the same time, our research team believes selective outliers in IPPs (due to US$ returns), banking and textile merit a second look with current market valuations. The AKD Research Team will continue providing insight to their top picks, however for investors reading this report we provide 10 stocks at a 15% discounted valuation set, which we believe will outperform as improving risk tolerance stemming from returning confidence (through policy response) outweighs the bottom of the corporate earnings cycle.

Sector Valuations - Regional vs. Pakistan

	PER		EPS Growth		PBV		ROE		DY	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Regional Automobiles	8.10	6.90	21%	16%	1.00	0.90	13.4%	13.90%	3%	3%
Pakistan Automobiles	**7.64**	**10.52**	**-48%**	**-27%**	**0.78**	**0.75**	**10.2%**	**7.13%**	**4%**	**3%**
Regional Banks	9.10	8.30	5%	9%	1.20	1.10	20.0%	14.90%	6%	6%
Pakistan Banks	**6.30**	**6.20**	**14%**	**1%**	**1.40**	**1.20**	**23.5%**	**20.70%**	**7%**	**8%**
Regional Energy	8.00	6.60	18%	21%	1.50	1.20	19.1%	19.90%	5%	5%
Pakistan E&P	**7.80**	**5.74**	**12%**	**36%**	**3.46**	**2.83**	**44.3%**	**49.40%**	**10%**	**13%**
Pakistan OMCs	**3.50**	**6.81**	**256%**	**-49%**	**1.70**	**1.56**	**48.5%**	**22.94%**	**11%**	**9%**
Regional Insurance	18.30	12.90	-37%	41%	2.00	1.70	10.9%	14.40%	0%	4%
Pakistan Insurance	**5.6**	**9.3**	**-18%**	**-40%**	**1.80**	**1.60**	**32.0%**	**17.22%**	**2%**	**3%**
Regional Materials / Fertilizers	8.00	5.60	2%	43%	1.50	1.10	20.0%	22.70%	5%	5%
Pakistan Materials / Fertilizers	**7.44**	**6.77**	**-16%**	**10%**	**2.06**	**1.80**	**27.6%**	**26.60%**	**9%**	**10%**
Regional Telecom Services	11.10	9.90	10%	13%	2.00	1.60	17.7%	20.00%	10%	6%
Pakistan Telecom Services	**n.m**	**7.95**	**n.m**	**n.m**	**1.56**	**1.56**	**n.m**	**19.67%**	**3%**	**13%**
Regional Utilities	15.00	14.90	-22%	1%	1.30	1.20	8.9%	8.60%	4%	4%
Pakistan Utilities (Power)	**5.50**	**6.97**	**38%**	**-21%**	**1.21**	**1.19**	**22.0%**	**17.13%**	**13%**	**14%**

Source: AKD Research, MSCI & Datastream

AKD Universe Companies Valuation

Symbol	17-Oct* Price (PkR)	AKD Recomm.	Fair Value (PkR)	Upside Potential / Downside Risk (%)	EPS (PkR) 2009F	EPS % 2009F	PER (x) 2009F	PBVS (x) 2009F	Div. Yield 2009F
FFC	85.00	Buy	159.5	87.6	17.6	22%	4.8	3.2	20.0%
OGDC	80.27	Buy	139.7	74.0	16.4	42%	4.9	2.6	17.0%
HUBC	18.24	Buy	37.1	103.4	2.8	23%	6.6	0.7	15.0%
PTC	26.78	Buy	58.3	117.7	4.0	n.m	6.8	1.3	15.0%
POL	206.98	Buy	410.1	98.1	43.3	-1%	4.8	1.6	13.0%
NBP	80.89	Buy	126.7	56.7	21.3	11%	3.8	0.8	9.3%
BAFL	26.56	Buy	39.0	47.0	5.4	12%	4.9	1.0	8.0%
ENGRO	153.37	Buy	303.2	97.7	19.4	-7%	7.9	1.1	6.0%
ICI	107.94	Buy	207.9	92.6	15.3	16%	7.0	1.1	6.0%
PSMC	71.22	Buy	105.0	47.4	5.2	20%	13.8	0.4	1.0%

*Discounted by 15%

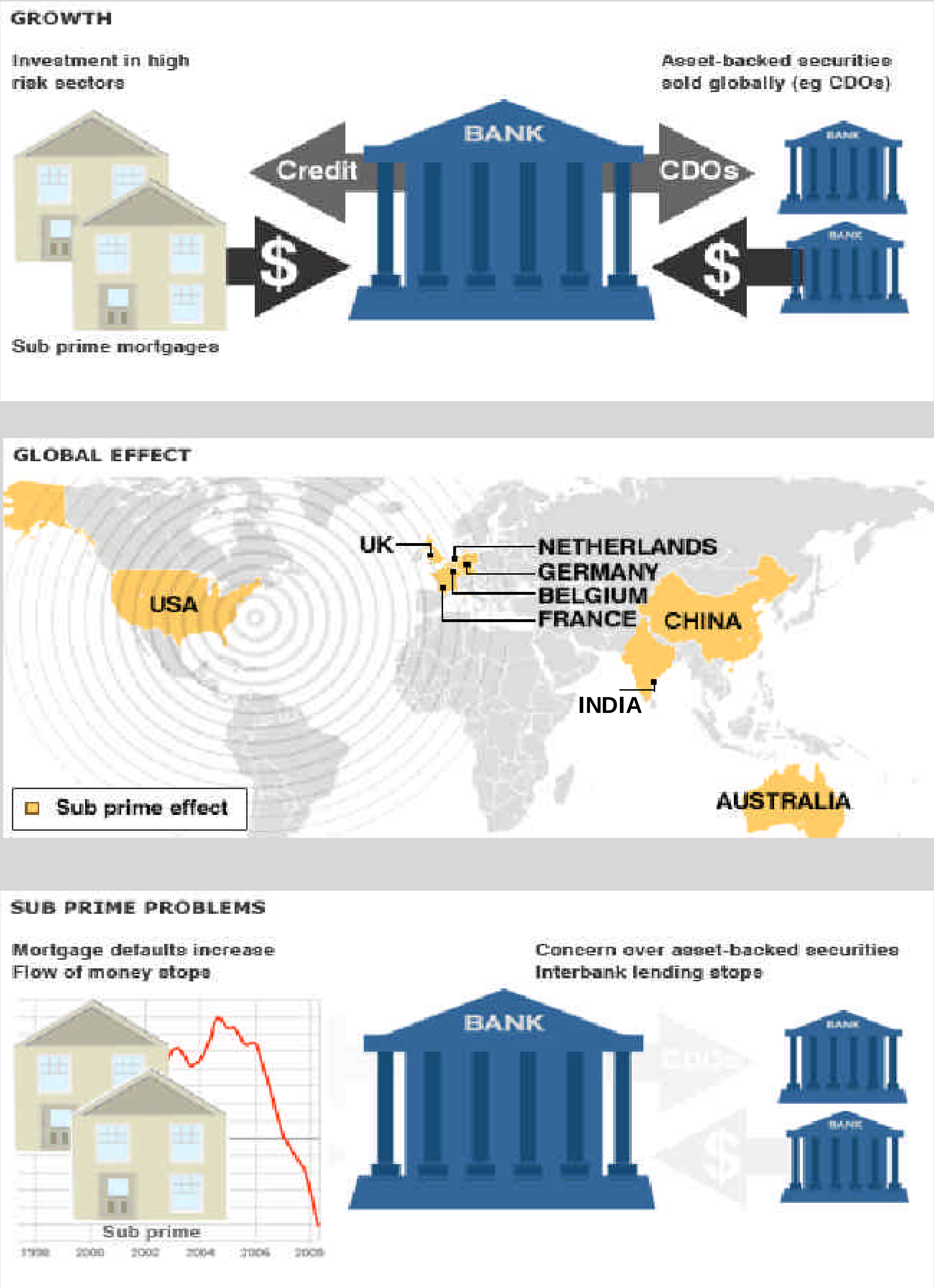
Source: AKD Research

AKD Universe Valuation

October 17, 2008*	FY05A	FY06A	FY07A	FY08A/E	FY09F
EPS (PkR)	6.8	8.1	8.2	8.8	10.5
EPS chg (%)	34.7	19.3	1.4	7.7	19.1
Price to Earnings (x)	8.9	7.5	7.4	6.9	5.8
Price to Book (x)	2.5	2.0	1.7	1.5	1.3
Price to CF (x)	6.9	7.0	8.3	5.8	5.5
Earnings Yield (%)	11.2	13.4	13.5	14.6	17.4
Dividend Yield (%)	6.3	7.1	7.4	8.5	10.7
Book Value per Share (PkR)	24.4	29.5	35.9	41.0	46.1
Return on Equity (%)	27.6	27.3	22.7	21.4	22.7
Return on Assets (%)	5.9	6.1	5.2	5.0	5.4
Chg in Sales (%)	29.6	29.4	10.4	21.8	12.3
Gross Margin (%)	35.3	33.4	31.1	30.3	29.5
Operating Margin (%)	23.7	22.5	19.8	18.8	19.9
Net Margin (%)	16.8	15.5	14.2	12.6	13.3
Payout (%)	56.5	52.9	54.9	58.4	61.8
EV / EBITDA (x)	5.1	4.4	4.4	3.9	3.6
FCFE Yield (%)	8.3%	6.9%	9.2%	11.3%	14.1%

*Discounted by 15%

Source: AKD Research

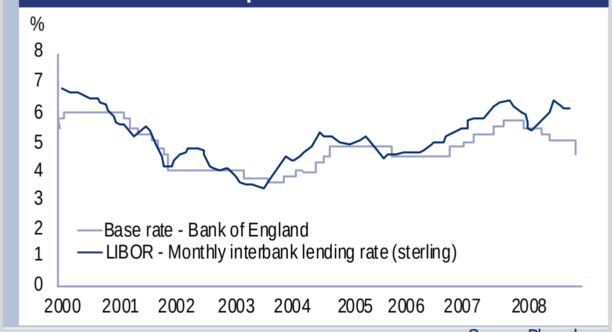


Source: www.bbc.co.uk

Source: www.bbc.co.uk

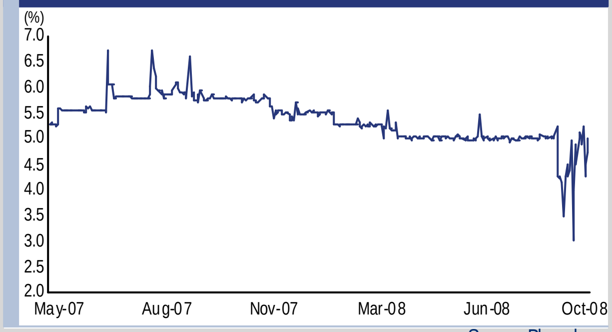
Tight Liquidity - Both Abroad and at Home

UK: LIBOR-Base Rate Spread



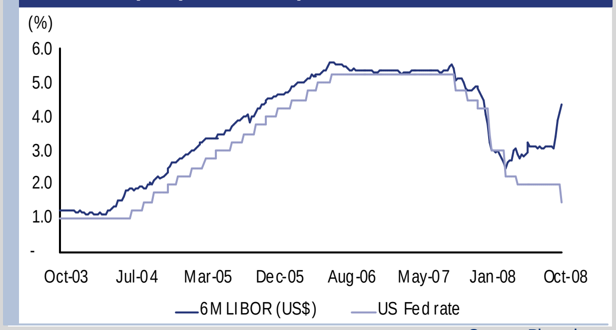
Source: Bloomberg

UK O/N Rate



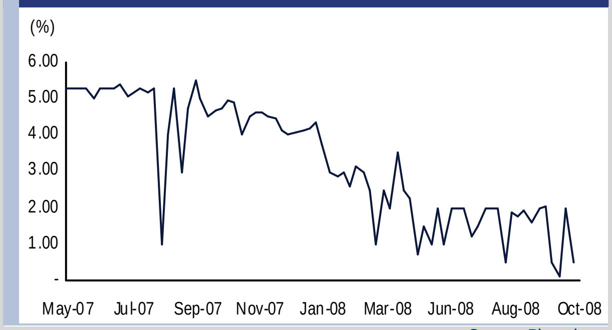
Source: Bloomberg

US: LIBOR (US$)-Fed Rate Spread



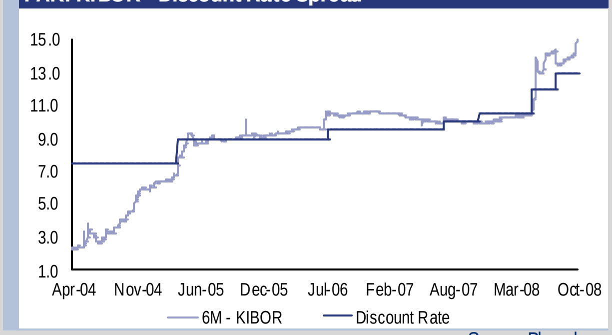
Source: Bloomberg

US O/N Rate



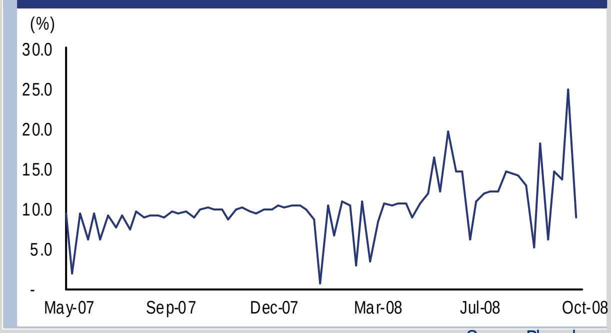
Source: Bloomberg

PAK: KIBOR - Discount Rate Spread

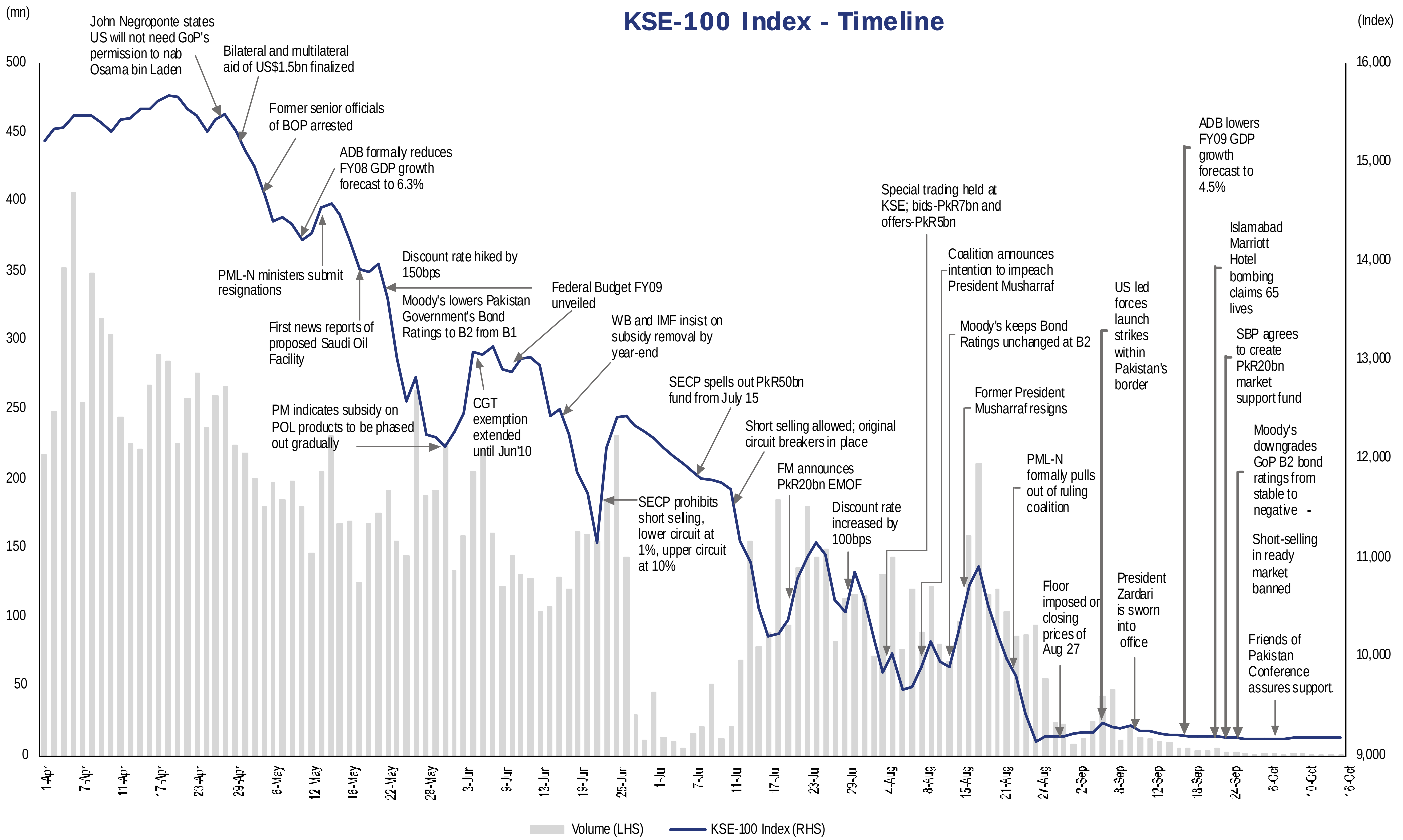


Source: Bloomberg

PAK O/N Rate



Source: Bloomberg


KSE-100 Index - Timeline
(mn)
(Index)
John Negroponte states US will not need GoP's permission to nab Osama bin Laden
Bilateral and multilateral aid of US$1.5bn finalized
Former senior officials of BOP arrested
ADB formally reduces FY08 GDP growth forecast to 6.3%
PML-N ministers submit resignations
First news reports of proposed Saudi Oil Facility
Discount rate hiked by 150bps
Moody's lowers Pakistan Government's Bond Ratings to B2 from B1
Federal Budget FY09 unveiled
WB and IMF insist on subsidy removal by year-end
PM indicates subsidy on POL products to be phased out gradually
CGT exemption extended until Jun'10
SECP spells out PkR50bn fund from July 15
SECP prohibits short selling, lower circuit at 1%, upper circuit at 10%
Short selling allowed; original circuit breakers in place
FM announces PkR20bn EMOF
Discount rate increased by 100bps
Special trading held at KSE; bids-PkR7bn and offers-PkR5bn
Coalition announces intention to impeach President Musharraf
Moody's keeps Bond Ratings unchanged at B2
Former President Musharraf resigns
PML-N formally pulls out of ruling coalition
Floor imposed on closing prices of Aug 27
US led forces launch strikes within Pakistan's border
President Zardari is sworn into office
ADB lowers FY09 GDP growth forecast to 4.5%
Islamabad Marriott Hotel bombing claims 65 lives
SBP agrees to create PkR20bn market support fund
Moody's downgrades GoP B2 bond ratings from stable to negative
Short-selling in ready market banned
Friends of Pakistan Conference assures support.
500
450
400
350
300
250
200
150
100
50
0
16,000
15,000
14,000
13,000
12,000
11,000
10,000
9,000
1-Apr
7-Apr
11-Apr
17-Apr
23-Apr
29-Apr
8-May
12-May
18-May
22-May
28-May
3-Jun
9-Jun
13-Jun
19-Jun
25-Jun
1-Jul
7-Jul
11-Jul
17-Jul
23-Jul
29-Jul
4-Aug
8-Aug
15-Aug
21-Aug
27-Aug
2-Sep
8-Sep
12-Sep
18-Sep
24-Sep
6-Oct
10-Oct
16-Oct
Volume (LHS)
KSE-100 Index (RHS)

Asad Farid Khwaja

Economist
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Economic outlook: Cornering sharp edges

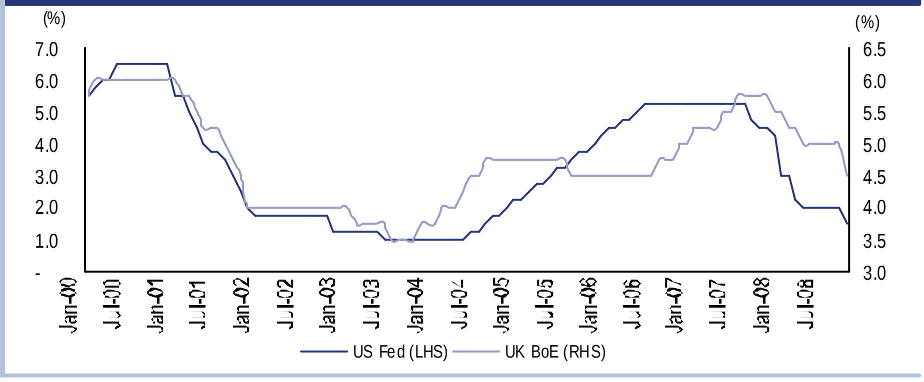
Like all other developed and emerging economies, Pakistan also experiences economic distresses induced by the global spike in commodity prices and spreading infection from the international financial turmoil. The GoP has taken unpopular yet necessary measures on the fiscal and monetary fronts to counter these exogenously-induced economic challenges. In our view, the GoP's corrective economic policies coupled with the recent significant downturn in international commodity prices is leading to a consistent albeit gradual turnaround in the economy. We are of the view that as this process continues it will lead to an eventual rebalancing of Pakistan's trade and current accounts. Hence the country's Forex reserves which have declined to their current level of US$7.7bn should eventually rebound and the exchange rate should again stabilize.

As the SBP progressively slackens its tight monetary stance, economic growth which slumped to 5.8% in FY08, should start picking up.

In FY08 Pakistan imported 1.8MT of wheat at a price of US$471.6/MT

State Bank of Pakistan, like other Central Banks in the region and all over the world, recently decided to slash its Cash Reserve Requirement for Banks by a total of 4% by Nov'08. In addition, the Reserve Bank of India today slashed its base repo rate for the first time in the last 4 years by 100bps to 8%. This raises the likelihood of the SBP following suit. As the SBP progressively slackens its tight monetary stance, economic growth which slumped to 5.8% in FY08, should start picking up. In addition, considering the geopolitical importance of Pakistan we think that the GoP will be successful in obtaining the necessary external financing from bilateral donors and multilateral agencies like the ADB and the World Bank, which should further augment economic stability. This makes GoP's recourse for an IMF bailout package a limited possibility.

Interest rates globally are being brought down



Source: Reuters

Inflationary pressures are easing…

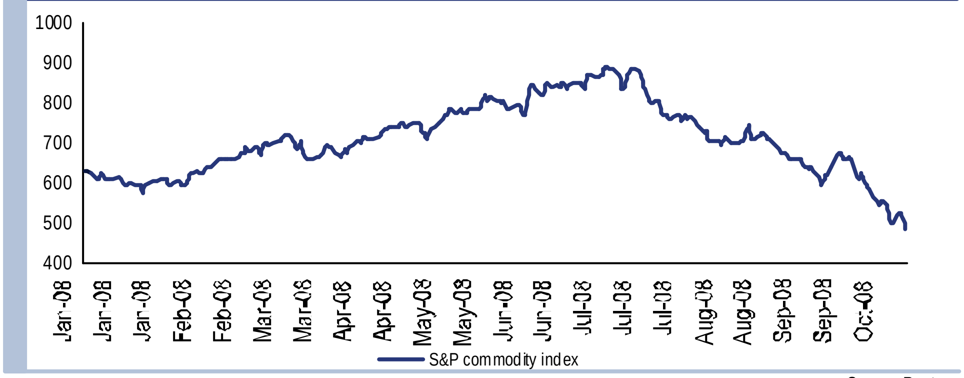
Much to the concern of the domestic economic managers, inflationary pressures have increased consistently in the last twelve months. This is reflected in the consistent rise in both headline and core inflation, which prompted the State Bank of Pakistan to progressively tighten its monetary stance by jacking up the discount rate, CRR and SLR. We have always maintained and still do, that with the restoration of fiscal discipline and the easing of exogenous global supply/demand side pressures, domestic inflationary pressures would automatically fade, making the justifications of retaining a tight monetary stance extremely tenuous. In our view, a tight monetary stance in the current circumstances has been a counterproductive strategy.

The significant reduction in headline inflation during Sep'08 due to the downturn in global commodity prices despite removal of subsidies on fuel & power, lends credence to our argument.

The significant reduction in headline inflation during Sep'08 due to the downturn in global commodity prices despite removal of subsidies on fuel & power, lends credence to our argument. In this regard, it is important to highlight that international oil (WTI) price has plunged to its 13month low to US$73.66/bbl while soft commodities like wheat and palm oil have also shown significant downward correction. International wheat futures have declined to AU$288/MT, 33.4% below peak levels while palm oil price has reached its 22 month low of US$496/MT.

Declining inflationary pressures should encourage the Central Bank to reverse its tight monetary policy stance.

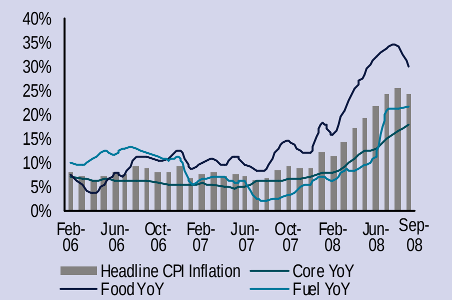
S&P commodity index has seen a persistent downward correction



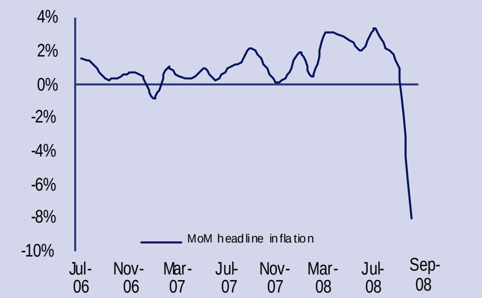
Source: Reuters

Declining inflationary pressures should encourage the Central Bank to reverse its tight monetary policy stance. In our view, the recent significant reduction in the CRR by the SBP is a clear indication that the monetary policy stance is changing. This is despite the SBP's statements to the contrary. In addition, Central Banks throughout the world and also in the region have started cutting interest rates to arrest the spreading economic contagion from the US. This should also encourage Pakistan's Central Bank to rethink and hopefully reverse its strategy. As interest rates are brought down, private credit creation and economic growth ought to rebound.

Fuel and core inflation will rise as subsidies are removed



Incremental inflation has plunged into the negative zone



Source: FBS

Oil Outlook remains bearish

WTI (West Texas Intermediate) has dived steeply from its all-time high US$145.31/bbl recorded on July 3, shedding US$75.46/bbl or 49.3% of its value. Recently, it breached its 200week moving average (74.71), which signifies a strong bearish trend. In absence of any bottoming indications, technical picture for oil remains bearish, despite the oversold conditions indicated by weekly OB/OS data.

According to our analysis, in immediate-term, crude oil is expected to extend this bearish wave towards US$55.80/bbl-US$56/bbl. A breakdown with 3-day confirmation below mentioned levels would increase the probability for a move towards US$48.60/bbl-US$49/bbl, which might even extend further towards major support US$37/bbl-US$40/bbl. Meanwhile, any pullback would be limited to US$76.80/bbl-US$77/bbl, as it would require strong momentum to break this formidable resistance and reverse the short-term trend.

Source: AKD Technical Analyst
qasim.anwar@akdsecurities.net

Economic Imbalances

Fiscal discipline being enforced...

Market distorting subsidies on fuel & power are being removed in order to meet the GoP's budgetary expenditure targets for FY09. To achieve this, domestic fuel prices and power tariffs have been jacked up.

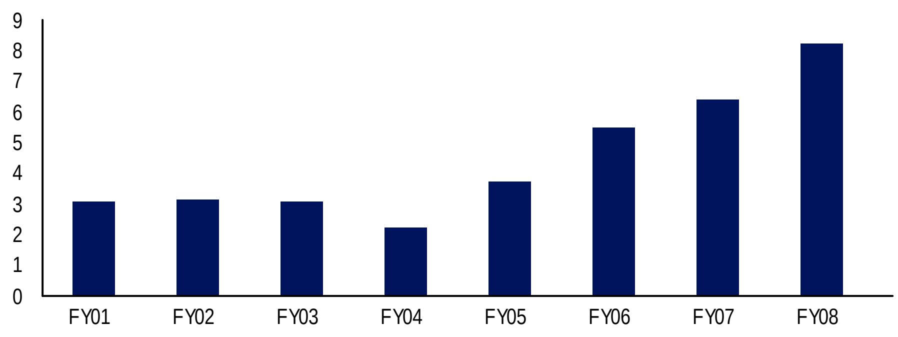
The new political administration has aggressively enforced an austere fiscal regime after coming to power. Market distorting subsidies on fuel & power are being removed in order to meet the GoP's budgetary expenditure targets for FY09. To achieve this, domestic fuel prices and power tariffs have been jacked up. In addition, the GoP has committed to net zero inflationary borrowing from the Central Bank, which is laudable. At the same time, the GoP recently issued new National Saving Schemes (NSS) to fulfill its financing needs by tapping non-bank sources of funding and also agreed to cut development expenditures in order to rationalize overall expenditures. Reestablishment of fiscal discipline should help reduce overall financing requirements of the GoP.

It has to be highlighted that credit to private sector in 1QFY09 has contracted by PkR4bn while credit to public enterprises has increased by a similar amount. This explains, to a considerable degree, the liquidity crunch in the private sector and hence calls for greater fiscal austerity measures, in our view.

As a result of these positive developments, we think that the fiscal deficit in FY09 will be significantly lower as compared to that in the previous fiscal year. However, we remain proponents of greater level of fiscal discipline which comes with a balanced budget approach. In this regard it has to be highlighted that credit to private sector in 1QFY09 has contracted by PkR4bn while credit to public enterprises has increased by a similar amount. This explains, to a considerable degree, the liquidity crunch in the private sector and hence calls for greater fiscal austerity measures, in our view.

Although GoP's Central Bank borrowing increased to PkR264bn during 1QFY09, we still think that as the subsidy burden is reduced, recourse to Central Bank borrowing will be limited. In this regard, as per the recent price notification released by OGRA, the GoP has effectively removed all subsidies on petroleum products and instead has started collecting Petroleum Development Levy. This should limit the chances of fiscal slippages in FY09 and instead raise the possibility of eventual retirement of Central Bank debt.

Historical trend in Fiscal Deficit as a % of GDP



Source: Reuters

External deficits are contracting!

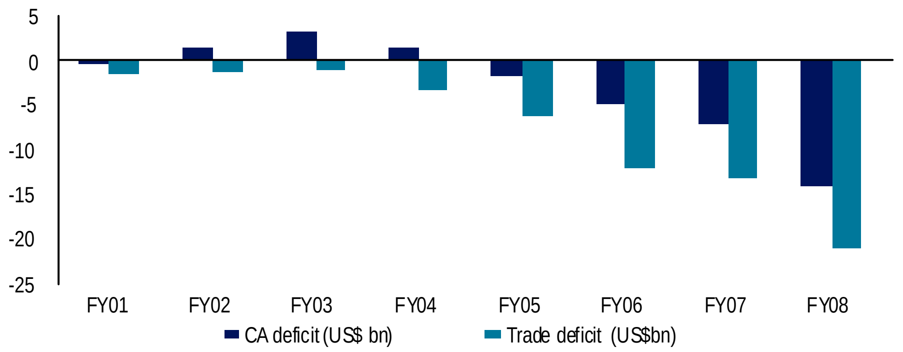
In the past 5 months, import growth has declined substantially. The slowdown in import growth reflects 1) reduction in global commodity prices, 2) rapid PkR depreciation and 3) slowdown in domestic economic activity.

In the past 5 months, import growth has declined substantially. The slowdown in import growth reflects 1) reduction in global commodity prices, 2) rapid PkR depreciation and 3) slowdown in domestic economic activity. Export growth on the other hand has remained robust since the start of the current year, at 22%YoY. As a result, the Twin Deficits have contracted since Apr'08. Although Aug'08 and Sep'08 trade figures are less than encouraging, we do not think that they signify a change in trend. Going forward, we are of the view that the recent import curtailment measures taken by the GoP, which include the imposition of regulatory duties and LC margin on imported luxury items, should further help in reducing import demand and in curtailing external imbalances.

In light of the ongoing correction in global commodity prices we think that Pakistan's external imbalances will be short-lived and GoP's external financing requirements will shrink.

At the same time, remittance inflow remains strong which should further help in bridging the CA gap. Furthermore, in light of the ongoing correction in global commodity prices we think that Pakistan's external imbalances will be short-lived and GoP's external financing requirements will shrink. However, recently the exchange rate spread between the open and interbank markets has expanded sharply which poses a potential risk to remittance inflow through official channels. Currently, we retain our remittance projection of US$7.5bn for FY09.

External imbalances increased significantly in FY08



Source: Reuters

The following table shows BoP imbalances under different international oil price scenarios. However, considering that soft commodity prices have also plunged there remains a greater downside to these figures.

Oil Price Sensitivity Analysis

		Average international oil prices in FY09 (US$/bbl)				
		40.0	50.0	60.0	70.0	96.8
Import price						
Petroleum Products (US$/MT)		249.1	311.3	373.6	435.9	603.0
Petroleum Crude (US$/MT)		249.9	312.4	374.8	437.3	605.0
Import Volume						
Petroleum Products(MT)	11,225,987					
Petroleum crude (MT)	8,981,536					
Oil Imports (US$bn)						
Petroleum Products		5	6	8	9	12
Petroleum Crude		3	3	4	5	7
Imports (US$ bn)		39.84	41.10	42.36	43.62	47.00
Trade Deficit (US$bn)		15.84	17.10	18.36	19.62	23.00
CA deficit ((US$bn)		5.84	7.10	8.36	9.62	13.00
Oil import volume growth assumption					FY08	FY09 (P)
Petroleum Products (% increase)					18.9	10
Petroleum Crude (% increase)					5.2	4

Source: AKD Research & SBP

External inflows, Forex Reserves and PkR stability: The Interlinked Triumvirate!

With the BoP gap expected to shrink considerably in the current fiscal year, pressures on the country's forex reserves should also fade. In addition, more likely than not, significant external inflows should materialize in FY09 considering the partial success of the "Friends of Pakistan's" conference recently held in New York. In the wake of expected external inflows, foreign debt management should not be very difficult for the GoP. Moreover, International Financial Institutions like the World Bank and the ADB have already agreed to provide about US$3.5bn project and program financing to

It is important to highlight that Pakistan's external debt profile has improved significantly in the last eight years due to debt restructuring and retirement of expensive loans.

Pakistan in FY09. In addition, the ADB has reportedly approved a US$2bn soft loan for the construction of light rail transit system for Karachi. These external inflows in addition to the financial assistance assured recently by China, should stabilize the economy and reverse the decline in the country's Forex reserves.

Furthermore, considering the geopolitical importance of Pakistan in the global war against terror, it seems logical to expect Pakistan's allies to help the GoP manage the short term and temporary liquidity problems caused primarily by exogenous shocks. In this regard, it is important to highlight that Pakistan's external debt profile has improved significantly in the last eight years due to debt restructuring and retirement of expensive loans. If the GoP manages to obtain firm commitments in the Friends of Pakistan's conference to be held in Abu Dhabi in Nov'08, we think that Forex reserves will rise, the PkR exchange rate will stabilize and overall BoP stability will be restored.

External debt burden has reduced significantly

	FY01	FY08
External Debt as a % of GDP	52	27
Debt Servicing as % of GDP	2.8	0.8

Source: Ministry of Finance

What would an IMF policy regime entail for Pakistan?

We remain cognizant that in the unlikely scenario where the BoP imbalances fail to shrink and anticipated foreign capital inflows remain depressed, the subsequent challenging external debt management conditions might make an IMF economic bailout the only option. In these settings how will the economy fare?

We agree that an IMF package will most likely entail certain policy requirements particularly demand curtailment measures on monetary and fiscal fronts which might aggravate the slump in near term economic activity. However, we think that requirements which encourage fiscal discipline, in addition to the austere tightening measures already taken by the GoP, will surely be positive for the country's broader economic health. On the other hand, monetary tightening measures, especially further jacking up of the policy discount rate, though certainly unwelcome, should not last for long. As downward correction in commodity prices continues it should lead to an automatic stabilization of the economy and lower inflationary expectations. Therefore, an IMF program, in our view, will only postpone an inevitable monetary easing by at most two quarters. In the interim period, real GDP growth might slump to around 3%, similar to levels during years when Pakistan was following an IMF policy regime. However, the eventual reduction in interest rates ought to stimulate domestic demand, credit creation and hence economic growth in FY10. In addition, the GoP has already taken the necessary fiscal reforms, especially removed market distorting subsidies on Fuel & Power. This

Structure of EDL (End Mar'08)

Components	% Share
Paris Club	31.6
Multilateral	46.9
Other Bilateral	2.6
Short-Term	1.3
Private Non-Guaranteed	5.4
IMF	3.1
Other Bilateral	6.2
Forex Liabilities	2.9

Source: SBP

improves the leveraging power of the GoP during negotiations with the IMF and raises the chances of obtaining external financing with less strings attached.

Apart from the completion of the fist generation of economic reforms, the IMF policy framework might also include the implementation of the second generation of economic reforms. This would include developing high quality institutions of political & economic governance which are transparent, accountable, and efficient. Institution building which lowers corruption and encourages fiscal transparency ought to provide long term growth dividends for the economy. Therefore an IMF policy regime though unlikely and certainly unwelcome should not be taken as harbinger of an economic downturn.

GoP's US$4bn External Financing Plan

Plan A	**Multilateral Agencies**		
		World Bank	US$1.5bn
		ADB	US$1.6bn
		DFID	US$0.865bn
		IDB	US$0.5bn
	US$1.5bn through Securitization of remittances		
Plan B	**Assistance from Friends of Pakistan (China and Saudi Arabia)**		
Plan C	**IMF financing without conditionalities**		

Source: SBP

The report title questions whether this is it. Perhaps for global markets but certainly not for Pakistan!

We, Muhammad Farid Alam and Asad Farid, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is/or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. We further certify that we do not have any beneficial holding of the specific securities that we have recommendations on in this report.